

200951

NO. _____

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

PETER M. ELLIOTT, Trustee for
VAN'S MARKET, a copartnership
composed of KENNETH M. PRICE
and WILLIAM R. BABINEAU,

Appellant,

v.

A. J. BUMB, Trustee for
SECURITY CURRENCY SERVICES,
LTD., and CORPORATIONS
COMMISSIONER OF STATE OF
CALIFORNIA,

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION

BRIEF OF APPELLEE CORPORATIONS
COMMISSIONER OF THE STATE OF CALIFORNIA

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FILED

AUG 26 1965

FRANK H. SCHMID, CLERK

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UNITED STATES COURT OF APPEALS
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PELIER M. ELLIOTT, Trustee for
VAN'S MARKET, a copartnership
composed of KENNETH M. PRICE
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v.

A. J. BUMB, Trustee for
SECURITY CURRENCY SERVICES,
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COMMISSIONER OF STATE OF
CALIFORNIA,

Appellees.

NO. _____

BRIEF OF APPELLEE CORPORATIONS
COMMISSIONER OF THE STATE OF CALIFORNIA

INTRODUCTORY STATEMENT

As is set forth at pages 4-5 of Appellant's
Opening Brief, the Corporations Commissioner of the
State of California has no monetary interest or claim
to the funds in question here. However, the Corporations
Commissioner is charged with the responsibility of
enforcing the Check Sellers and Cashers Law (set
forth at sections 12000, et seq. of the Financial
Code of the State of California) and in carrying out
this responsibility, is deeply concerned with the
interpretations placed upon said law by any court in
which an interpretation becomes necessary.

1 JUDICIAL STATEMENT

2 Appellee Corporations Commissioner of the State
3 of California (hereinafter sometimes referred to as "com-
4 missioner") adopts by reference the jurisdictional
5 statement of appellant set forth at pages 2-3 of Appellant's
6 Opening Brief.

7 STATEMENT OF FACTS

8 The facts relating to this proceeding are sat-
9 isfactorily set forth in Appellant's Opening Brief at
10 pages 3-5.

11 Supplementary thereto, appellee commissioner
12 brings to the attention of the court that the "Agency
13 Franchise and Trust Agreement" entered into by Security
14 Currency Services, Ltd., (hereinafter sometimes referred
15 to as Security Currency) and Van's Market on November 15,
16 1962, contains the following pertinent language:

17 ". . . Security Currency . . . does hereby appoint
18 Van's Market . . . as its Agent for the purpose
19 of issuing Money Orders.

20 "1. Agent shall accept responsibility and
21 liability for properly issuing all Money Orders and
22 shall account for and remit all proceeds for face
23 value issued plus 50% of fees therefrom to Security;
24 Agent shall hold all said moneys in trust for Security
25 entirely separate and apart from other funds in
26 possession of Agent until remitted. . . ." (R-134.)

THE JOINTLY OWNED BY VAN'S MARKET OF
\$1,094.17 WHICH IS HELD IN TRUST FOR
REVENUE TAXES OF IMPRESSES THE OTHER
ASSETS OF VAN'S MARKET WITH A TRUST
IN SAID AMOUNT IN FAVOR OF SECURITY
CURRENT IN THAT AMOUNT. NEITHER
SECTION 67(D)(2) NOR SECTION 64(A)(5)
OF THE BANKRUPTCY ACT INVALIDATES
THIS TRUST INTEREST

A. The California Law Including Financial Code
Section 12300.3

Section 12300.3 of the California Financial Code
provides in pertinent part:

"All funds received by a licensee or its agents
from the sale of . . . money orders . . . shall con-
stitute trust funds owned by and belonging to the
person from whom they were received or a licensee
who has paid the . . . money orders . . . for which
the funds of such persons have been received by the
agent but not transmitted to such licensee or
deposited in the trust account of such licensee.
If . . . an agent of a licensee shall commingle such
funds with those of his own, all assets of such agent
shall be impressed with a trust in favor of said
purchaser or the licensee in an amount equal to the
aggregate funds received or which should have been
received by the agent from such sale. Such trust
shall continue until an amount equal to said funds
is separated from those of the agent and transmitted

1 to the licensee or deposited in the trust account
2 of licensee. . . ."

3 This section was designed to preserve the integ-
4 rity of trust funds and, if the agent of the check seller
5 commingled funds which he held in trust with his own
6 assets, then to impress a trust upon all the assets of
7 the agent so as to further preserve the integrity of the
8 funds. That the legislation was designed to cope with
9 the problem of tracing commingled trust funds (rather
10 than establishing a priority to assets) is found from
11 that part of the Final Report of the Assembly Interim
12 Committee on Finance and Insurance of the State of
13 California which deals with the problem. Cal. Int. Comm.
14 Final Rep. on Finance and Insurance, 41-42; 2 (1963)
15 Cal. Assemb. J. app.

16 While it is clear that the committee was con-
17 cerned with the effect of bankruptcy on the funds held
18 by the agent consisting of proceeds from the sale of
19 money orders, it is also abundantly clear that the com-
20 mittee (and the State Legislature) was not concerned with
21 giving one type of debtor a priority in any bankruptcy
22 proceeding that might result but rather assuring the
23 purchasers of money orders that they would be honored
24 and assuring the check seller that upon his honoring and
25 paying such money orders, he would receive the moneys
26 which the agent was holding in trust for him. If the

1 agent commingled the funds held in trust, a trust was
2 impressed upon his assets until the sum was separated
3 out and paid to the principal.

4 Section 12309.3 of the Financial Code was
5 designed to implement the California law on the
6 principal-agent relationship which in and of itself
7 establishes the trust relationship existing between
8 principal and agent.

9 That an agent is treated as a trustee in
10 California is shown by section 2322 of the California
11 Civil Code:

12 ". . . An authority expressed in general terms,
13 however broad, does not authorize an agent:

14 ". . .

15 "3. To do any act which a trustee is forbidden
16 to do by [sections 2228-2239 of the Civil Code (deal-
17 ing with obligations of trustees)]."

18 Under this section an agent may not do any act which a
19 trustee is forbidden to do. Farrow v. Robert A. Klein
20 & Co., Inc., 111 Cal. App.310, 316 (1931),295 P. 566.
21 An agent is a fiduciary and his obligation of diligent
22 and faithful service is the same as that imposed upon a
23 trustee. Rodes v. Shannon, 222 Cal. App. 2d 721, 725
24 (1963),35 Cal. Rptr. 339; Spector v. Miller, 199 Cal.
25 App. 2d 87, 95 (1962),18 Cal. Rptr. 426. It goes with-
26 out saying that a trustee or agent who wrongfully

commingled the assets held for the benefit of the beneficiary or principal with his own in addition an involuntary trustee or co-constructive trustee of those assets. Cal. Civ. Code, §§ 2223, 2224; Angelo Securities Corp. v. Luten, 47 Cal. App. 3d 261, 268 (1941).

Many jurisdictions, as a matter of common law, hold that a trustee who uses trust assets to pay his own debts hold all his other assets in trust for the beneficiary of the trust to the extent that trust assets were diverted from the trust. See Bogert, Trusts and Trustees (2d ed. 1962) § 922, pp. 309-20; Taft, A Defense of a Limited Use of the Swollen Assets Theory Where Money has Wrongfully been Mingled with Other Money, 39 Col.L.Rev.172.

This, then, is the force of section 12300.3 of the Financial Code.

F. The Trust Relationships Established by California Law and Financial Code Section 12300.3 Are Not Invalidated by Section 541(c)(2) of the Bankruptcy Act

The trust relationships between Van's Market and Security Company by statute and general law are recognized as such by the Bankruptcy Act. (All sectional references are to the Bankruptcy Act unless otherwise indicated.) The creation of rights in property and trust relationships thereto is wholly a local question and the federal court will observe such rights and relationships. In re Weitzelmaier Const. Co., 34 F. Supp. 109-11 (W. D.

1 N.Y. 1940); see also Miscok v. Varick Bank of New York,
2 206 U.S. 28, 37-38 (1906).

3 Section 67(c)(2) provides in pertinent part
4 as follows:

5 ". . . [S]tatutory liens created or recognized by
6 the laws of any State for debts owing to any person
7 . . . on personal property not accompanied by
8 possession of, or by levy upon or by sequestration
9 or distraint of, such property, shall not be valid
0 against the trustee. . . ." (Emphasis added.)

1 The purpose of this section,

2 ". . . was to invalidate against the trustee claims
3 which were essentially priorities, but which States
4 had labeled 'liens' in an effort to avoid the order
5 of distribution established by Section 64, 11 U.S.C.A.
6 § 104." In re Baron, 165 F. Suppl. 186, 188 (D. Conn.
7 1958).

8 Appellant urges that section 67(c)(2) invalidates
9 Security Currency's interests in the assets turned over to
0 the trustee of Van's Market but this contention cannot
1 stand for the following independent reasons:

2 1. As is shown in this brief, supra, the assets
3 of Van's Market are impressed by section 12300.3 with a
4 trust, not a lien, in favor of Security Currency where
5 Van's Market commingles trust funds with its own.

6 Appellant, relying on 4 Collier on Bankruptcy

1 (14th ed. 1964) 122-53, argues the trust impressed by section
2 12300.3 of the Financial Code should be treated func-
3 tionally as a statutory lien within the meaning of
4 section 67(c)(2) of the Bankruptcy Act and invalidated.
5 Neither Collier nor appellant gives authority in sup-
6 port of the general proposition that some statutory
7 trusts may be treated as statutory liens or that the
8 trust here should be so treated. Congress added clause
9 2 to section 67(c) in 1952 and there existed at that
10 time cases, such as In re Heintzelman Const. Co.,
11 34 F. Supp. 109 (W.D.N.Y. 1940), wherein the court had
12 differentiated statutory trusts from statutory liens
13 and found section 67 of the Bankruptcy Act inapplicable
14 to the former. Under these circumstances, Congress'
15 failure to include statutory trusts within the language
16 of clause 2 of section 67(c) hardly supports appellant's
17 position and in fact leads to a contrary interpretation
18 of those provisions. See Sampsell v. Straub, 194 F. 2d
19 228, 230-32 (9 Cir. 1951), cert. denied, 343 U.S. 927.
20 It should also be noted that Collier itself recognizes
21 that section 67(c) of the Bankruptcy Act has no appli-
22 cation if the statutory trust is analogized to a con-
23 structive trust (4 Collier on Bankruptcy, supra, 122)
24 and that recognition of statutory enactments creating
25 trusts in favor of certain persons has been generally
26 regarded by bankruptcy courts as a matter of

1 applying and following local laws (4 Seller on Bankruptcy
2 1210).

3 No reasons are suggested by appellant for treat-
4 ing the trust here as a lien and indeed none can be
5 suggested upon an analysis of the relationships existing
6 between the seller of the money order (Security Currency)
7 and its agent (Van's Market). The policy behind section
8 67(c)(2) is apparently to protect unsecured creditors
9 against state-created priorities for what would other-
10 wise also be unsecured creditors. However as has been
11 shown above, the relationship between Security Currency
12 and its agent (Van's Market) is not one of creditor to
13 debtor, but rather of principal to agent and beneficiary
14 to trustee. Recognition of the provisions of section
15 12300.3 does not prefer Security Currency as an unsecured
16 creditor over other unsecured creditors but merely
17 enforces the trust and fiduciary relationship which always
18 exists between principal and agent.

19 Even accepting (solely for the sake of argument)
20 that one may look to the function of the statutory trust
21 in an effort to determine whether it should be invalidated
22 by section 67(c)(2), it is clear here that in no way should
23 Security Currency's interest be looked upon as a statutory
24 lien or as a device to give one type of creditor a priority.

25 That part of section 12300.3 of the Financial
26 Code with which we are here concerned is merely a

1 substitute for investing upon trust fund, being commingled
2 and Van's Market holds its assets in constructive trust
3 for Security Currency until it has separated out and
4 paid to Security Currency the sum which it had commingled
5 with its own assets.

6 2. Section 67(c)(2) invalidates only statutory
7 liens for debts. The relationship between Van's Market
8 and Security Currency is not that of debtor-creditor but
9 that of trustee-beneficiary such as exists between an
0 agent and his principal. The fact that the trustee com-
1 mingled trust assets with his own does not change the
2 relationship to that of debtor-creditor. Noble v. Noble,
3 198 Cal. 129, 133-34 (1926), 243 P. 439; Gunter v. Janes,
4 9 Cal. 643, 659 (1858), ("It is difficult to perceive
5 how, in sound logic or in simple justice, a trustee, by
6 his own voluntary act, may change his capacity, and
7 convert himself into a mere debtor. . . ." Burnett, J.,
8 on petition for rehearing.) Since the invalidating
9 provisions of section 67(c)(2) are applicable only to
0 statutory liens for debts, Rochelle v. City of Dallas,
1 264 F. 2d 166 (5 Cir. 1959), cert. denied 361 U.S. 827;
2 In re Baron, 165 F. Supp. 186, 188 (D. Conn. 1958), it
3 has no application to the case at hand.

4 In the instant case Credit Managers Association
5 realized \$2,987.56 as proceeds from the liquidation of
6 assets of Van's Market and trust moneys in the amount of

1 \$1,094.17 commingled by Van's Market with its assets.
2 Because of the fact that Van's Market had commingled
3 trust funds with its own, these proceeds in liquida-
4 tion were impressed with a trust in favor of Security
5 Currency to that amount. Until that sum is extracted
6 and paid to Security Currency these liquidation proceeds
7 remain impressed with that trust and never become a
8 part of the bankrupt estate of Van's Market.

9 C. Security Currency's Interest Is Not
10 Invalidated by Section 64(A)(5) of the
Bankruptcy Act

11 Appellant urges that the trust impressed by
12 section 12300.3 is a state created priority which is
13 invalid under section 64(a)(5) of the Bankruptcy Act.
14 App. Op. Fr. pp. 22-26. However, section 64 invalidates
15 nothing but merely designates the order and extent of
16 priority of various types of claims to assets of the
17 bankrupt's estate.

18 It nowhere determines what assets in the
19 possession of the bankrupt are a part of his estate and
20 what assets are not. It is well settled that assets
21 which a bankrupt holds in trust for another do not become
22 a part of his estate. See 4 Collier on Bankruptcy 1204.
23 Therefore, section 64 of the Bankruptcy Act has no
24 applicability.

25 /
26 /

1 D. The Trust Has Established Is Adequately
2 Traced to the Moneys Turned Over by
3 Credit Managers Association to the Trustee
4 in Bankruptcy of Van's Market

5 Appellants further assert that Security
6 Currency has failed to trace the trust res as it is
7 required to do. To the contrary, the trust impressed
8 by section 12300.3 of the Financial Code is upon all
9 the assets of Van's Market to the extent and until the
10 \$1,094.17 is paid over to Security Currency. The
11 proceeds realized by Credit Managers Association from
12 the liquidation of this \$1,094.17 together with the
13 assets of Van's Market is taken by the trustee in
14 bankruptcy subject to the trust obligation. 4 Collier
15 on Bankruptcy 1203.

16 II

17 THE \$2014.99 HELD BY CREDIT MANAGERS
18 ASSOCIATION AND REPRESENTING MONEY
19 ORDERS SOLD BY VAN'S MARKET AND PAID
20 BY SECURITY CURRENCY ARE CLEARLY
21 HELD IN TRUST FOR SECURITY CURRENCY.
22 NEITHER SECTION 64(A)(5) NOR SECTION
23 67(C)(2) SERVE TO INVALIDATE THIS
24 TRUST RELATIONSHIP AND SECURITY
25 CURRENCY'S INTEREST IN SAID TRUST

26 (The arguments heretofore made in respect to
the sum of \$1,094.17 commingled by Van's Markets are
just as applicable to the \$2,014.99 which is the subject
of the discussion here. To avoid repetition and because
even more compelling reasons dictate that the District
Court's order as respects this sum be affirmed, they are

1 not reported.)

2 Credit Managers Association holds \$2,014.99
3 representing money on deposit in a Van's Market account
4 and representing money orders sold by Van's Market for
5 Security Currency and which money orders had been
6 honored and paid by Security Currency.

7 By agreement Van's Market agreed to hold such
8 money "in trust for Security [Currency]." (R-134.)

9 Under general California law, Van's Market as agent of
0 Security Currency for the purpose of selling the
1 latter's money orders, held the proceeds in trust for
2 Security Currency. Since it has been stipulated and
3 found as a fact that this \$2,014.99 represents money
4 orders sold by Van's Market for Security Currency, no
5 question whatever arises in regard to tracing the
6 trust res.

7 Section 67(c)(2) clearly does not invalidate
8 Security Currency's trust interest since that interest
9 is not based on statute (although section 12300.3 of the
0 Financial Code also establishes this trust relationship
1 to the funds in question) but on the principal-agent
2 relationship between Security Currency and Van's Market
3 and their express agreement relating to the status of
4 funds received by Van's Market in the sale of Security
5 Currency money orders.

6 In addition to Security Currency's interest

1 not being a lien and not being a lien for a debt, it is
2 not invalidated by section 67(c)(2) of the Bankruptcy
3 Act because it arose from the terms of its contracts and
4 not from an economic relationship defined by the
5 legislature. In re New Haven Clock & Watch Company,
6 253 F. 2d 577, 582 (2 Cir. 1958). That section 64(a)(5)
7 of the Bankruptcy Act presents no problems is manifested
8 by the discussion, supra, page 11.

9 Appellant argues that no trust exists under the
10 Agency Franchise and Trust Agreement because no identi-
11 fiable trust res existed at the moment the contract was
12 signed. However, a declaration of trust may precede
13 acquisition of the trust res and attach to it thereafter.
14 Grubb v. General Contract Purchase Corporation, 94 F. 2d
15 70, 73 (2 Cir. 1938); see also Rest. of the Law, Trusts
16 2d (Vol. 1, 1959) § 26, Comment K; Bogert, Trusts and
17 Trustees (2d ed.) § 113, pp. 575-76. This rule has been
18 adopted in California by the dictum in Molera v. Cooper,
19 173 Cal. 259, 262 (1916), 160 P. 231:

20 ". . . A mere promise to obtain money and thereupon
21 hold it in trust does not create a trust until it is
22 at least so far executed that the money has been
23 obtained in accordance with the promise. . . ."

24 In support of his position appellant cites
25 Balian v. Balian's Market, 48 Cal. App. 2d 150 (1941),
26 119 P. 2d 426. That case involved an alleged oral

1 trust whereby a father and two of his sons agreed that
2 the earnings of all the members of the family (this
3 included five other children) would be placed in a
4 common fund and all property acquired placed in the
5 name of the father to be distributed in a certain
6 fashion upon the father's death. In holding that the
7 trial court properly nonsuited the proceeding by three
8 of the children to impress a trust upon certain property
9 of the father and of two of the other children, the
0 court noted that,

1 1. At the time the trust agreement was
2 entered into, most of the children (including the two
3 who were defendants) were minors;

4 2. There was no trust res because the \$160
5 which the father held at the time of the alleged
6 agreement had been used up in living expenses; and

7 3. The terms of the alleged agreement were
8 altogether too uncertain and tenuous to have warranted
9 the trial court impressing a trust upon any property.
0 Father than holding that no trust can arise from an
1 agreement to hold subsequently acquired property in
2 trust, the court rather emphasizes the uncertainty of
3 the agreement.

4 /

5 /

6 /

FOOTNOTES TO AGREEMENT

Section 67(c)(2) of the Bankruptcy Act does not invalidate the trust impressed upon the assets of the agent of a check seller who commingles assets held in trust for the check seller with his own since,

1. Section 67(c)(2) applies only to statutory liens, not trusts; and

2. Section 67(c)(2) invalidates only statutory liens for debts and not interests arising out of the principal-agent or trustee-beneficiary relationship. The assets upon which the trust is impressed is traced into the proceeds realized by Credit Managers Association upon liquidation of the assets of Van's Market and the trust funds commingled therewith which liquidation proceeds were turned over by Credit Managers Association to the trustee in bankruptcy of Van's Market. Since these assets were held in trust in favor of Security Currency until the amount of trust funds commingled therewith had been separated and paid over to Security Currency, they do not become a part of the bankruptcy estate of Van's Market and section 64(a)(5) of the Bankruptcy Act has no application.

The \$2,014.99 held by Credit Managers Association and representing money orders sold by Van's Market and paid by Security Currency are funds held in trust for Security Currency by agreement. Neither section

64(a)(5) nor section 67(c)(2) are in any way applicable to invalidate the trust relationship and the trustee in bankruptcy of Van's Market has no claim whatsoever to said funds.

It is respectfully submitted that the order of the District Court should be affirmed.

DATED: August 25, 1965

THOMAS C. LYNN, Attorney General

By ARTHUR C. DE GOEDE
ARTHUR C. DE GOEDE
Deputy Attorney General

DAVID W. HALPIN
Deputy Attorney General

Attorneys for Appellee
Corporations Commissioner of
State of California

600 State Building
Los Angeles, California 90012

CERTIFICATE.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

ARTHUR C. DE GOEDE

ARTHUR C. DE GOEDE

STATE OF CALIFORNIA)
) SS
COUNTY OF LOS ANGELES)

EVE M. BILLICK, being first duly sworn, deposes and says:

That affiant is and was, at all times herein mentioned, a citizen of the United States and a resident of the County of Los Angeles, over the age of twenty-one years and not a party to the within action;

That on August 25, 1965, affiant served the within BRIEF OF APPELLEE CORPORATIONS COMMISSIONER OF THE STATE OF CALIFORNIA upon persons listed below by depositing a true copy thereof in a United States mail box at Los Angeles, California, in a sealed envelope with postage thereon fully prepaid and addressed as follows:

GALL, WELLES & LADDIAN
458 South Spring St., No. 812
Los Angeles, California 90013
Attn: Robert A. Fisher, Esq.

SOLMEIER & KOPENZ
408 South Spring St., Suite 408
Los Angeles, California 90013
Attn: Robert W. Alberts, Esq.

That there is a regular communication by mail between the place of mailing and the place so addressed.

EVE M. BILLICK
EVE M. BILLICK

Subscribed and sworn to before
me this 25th day of August, 1965

IRIS M. NACHTEWEIN
IRIS M. NACHTEWEIN
Notary Public in and for said
County and State

